

## Costco Growth – Get Your Hot Dogs and Hearing Aids Here!

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Costco growth has always been spectacular since its inception as a single warehouse in Seattle in 1983. Starting from scratch, Costco was the first company to grow sales to \$3B in less than six years. By 2015, it ranked #2 in global retailing, just behind Walmart.

### The Big Box That Always Thinks Outside the Box

Costco's success is formulaic and time-tested. A limited selection of low-priced items, ranging from bulk (e.g., toilet paper) to luxury (e.g., diamond rings and watches), are offered in membership-only warehouses which themselves seem to reproduce as fast as bunnies (Fig 1). Item selection is far from static — new lines of business come and a few go (e.g., Costco Home).

Hearing aids are a business that came and stayed.

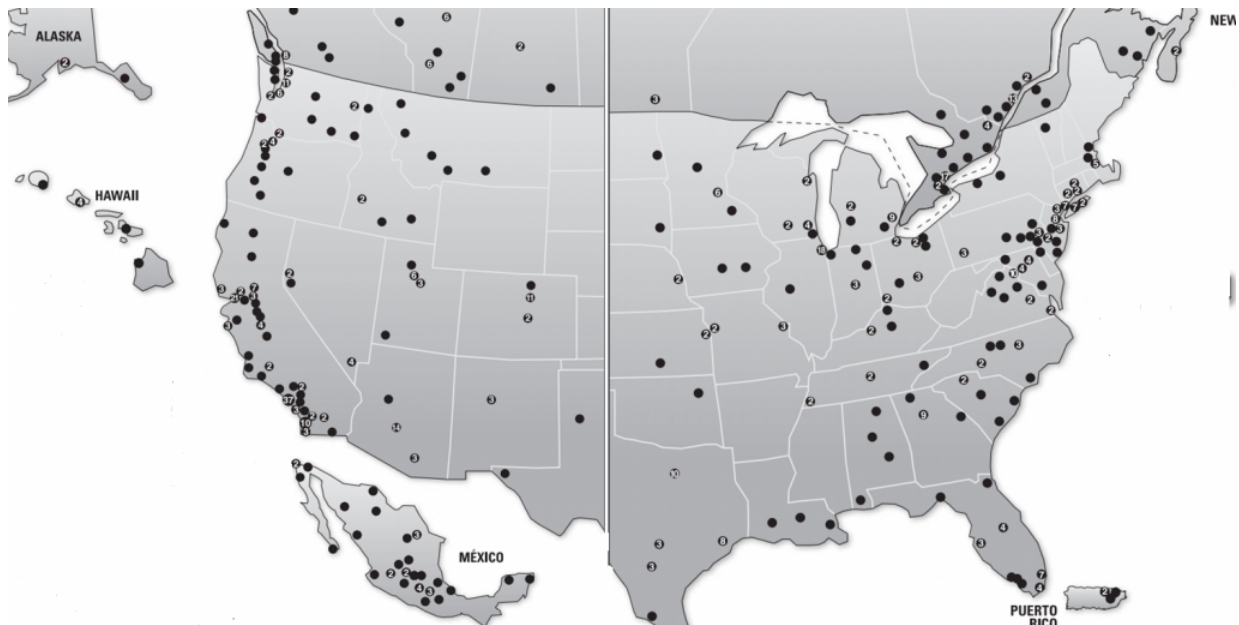


Figure 1. Costco Wholesale warehouse locations in US and Canada as of 12/31/2016, per Costco Annual Report.

### Hot Dogs and Hearing Aids

Hearing aids were introduced as a luxury item when Costco merged with Price Club in 1993/4. Keeping with its egalitarian success formula, Costco tossed hearing aids into its “ancillary business sales” section, right alongside hot dogs and gasoline.<sup>1</sup>

“*Hot Dogs and Hearing Aids*” isn’t a slogan or natural marketing approach for most, or maybe any, audiologists. Too bad for us. By 2004, Costco’s Annual Report was able to boast of:

“...our giant Kosher dogs regularly being named ‘Best Hot Dog’ in local competitions across the

country. And our ...Hearing Aid centers ... showed double-digit gains last year.”

Double-digit gains were, and remain, the result of the low-price formula, which Costco customers expect for hearing aids as well as hot dogs. The Costco 2003 Annual Report noted that “...*ancillary business sales ... increase(d) 20% over fiscal 2002.... Our members like to shop Costco for ...hearing aid(s)... because they know we offer the best quality at the best price...*”. And the rest is history, as Costco’s cryptic annual reports<sup>2</sup>, let on once in awhile:

- **2007:** “...*ancillary businesses...increased sales by more than 9% in fiscal 2007 to nearly \$9bil.*”
- **2011:** “*ancillary businesses...showed a sales increase of 24 percent in 2011.*”
- **2012:** “*Costco’s low prices on both brand-name and generic prescriptions are well-known, and we have gained our members’ trust for their healthcare needs. Such a relationship is invaluable when it comes to health-related services, and we have extended that trust into our optical and hearing aid businesses as well. Sales in our 469 hearing aid centers exceeded \$200 million in 2012, an increase of 22 percent from the previous year.*”
- **2013:** “*Costco Hearing Aid Centers...increased profitability at a higher rate than the rate of sales increase. Such results were aided by the newest version of our highly rated, top-of-the-line Kirkland Signature digital hearing aids.*”
- **2014:** “*Warehouse ancillary ... gross margin when expressed as a percentage of net sales increased by six basis points, predominately in our optical and hearing aid businesses.*”
- **2015:** “*Costco’s ancillary businesses (hearing aid centers) all performed well... Sales increased in all these operations*”
- **2016:** “...*ancillary businesses ... are all key components of our warehouses. (They) produced strong sales and profits performance in 2016 and helped drive incremental sales throughout the warehouse. We include ...ancillary offerings in new warehouse openings, whenever possible; as well as add these operations to existing locations, as part of planned remodels and relocations.*”

## Do Hearing Aids Drive Hot Dog Sales?

It would seem so, based on the 2012 and 2016 quotes above. Costco uses hearing aids and eye-glasses to get members to make a warehouse trip to fulfill their healthcare needs. And why not get the shopping done and have a couple hot dogs while they’re there? The double-digit annual revenue growth in ancillary services and the ripple effect to sales of other products raises several points:

- **Weight gain?** Hearing aids are a form of healthcare but a possible unhealthy link may exist between hearing aids and hot dog -induced weight gain. Whether this adverse effect exists cannot be substantiated at present due to lack of available data.
- **Profitability.** Double-digit revenue growth with low margins proves that store-in-store healthcare is a good line of business for Costco.
- **Access:** Burgeoning sales growth deflates the claim in public policy discussions that access to hearing healthcare is limited. Access is only a problem for those few who don’t have a Costco card or live in Wyoming<sup>3</sup> (see Fig 1).

## A New Distribution Channel

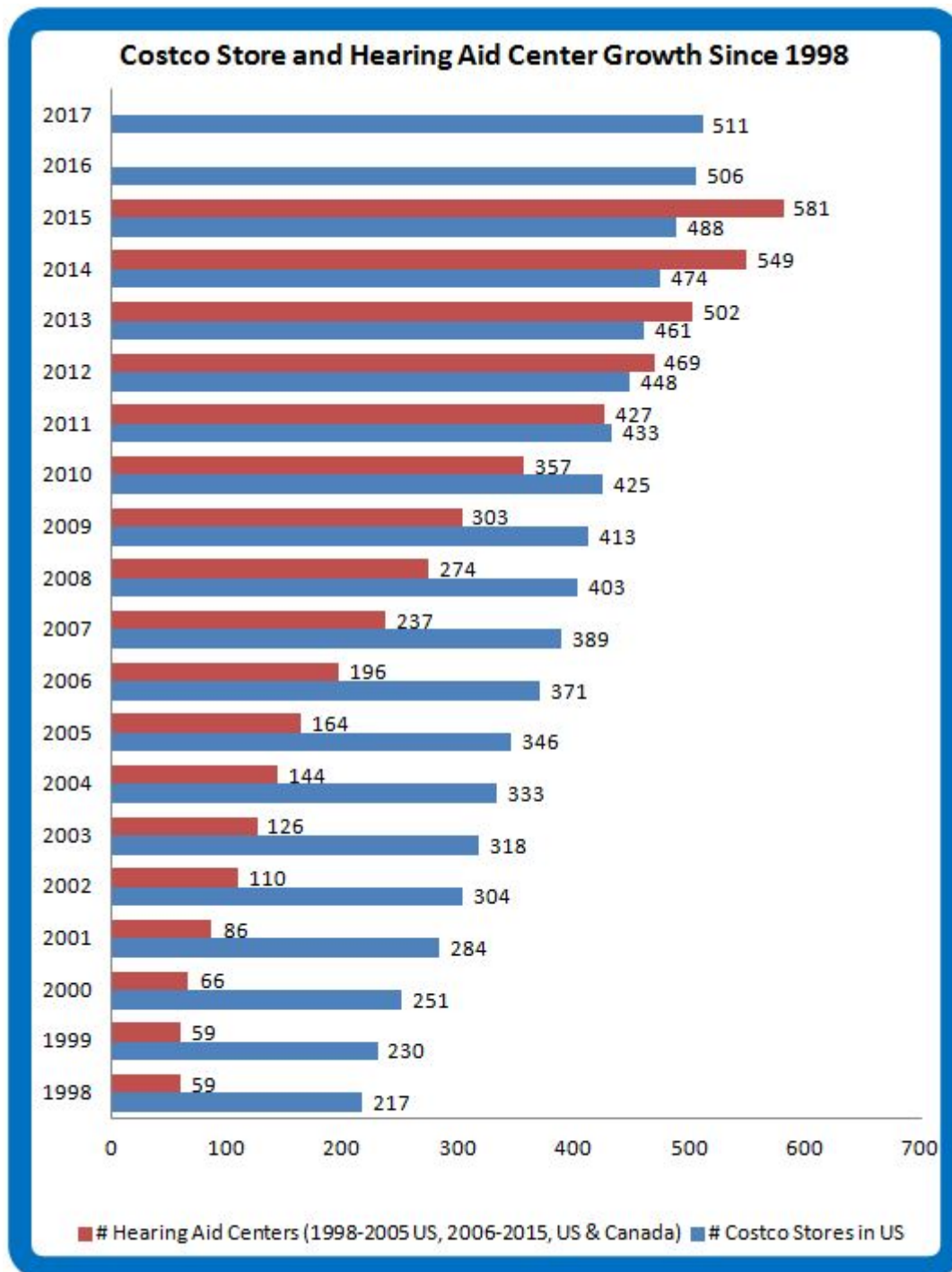


Figure 2. Annual growth of US Costco warehouses (blue) and Costco Hearing Aid Centers in US and Canada. (data from Costco Warehouse Annual Reports)

Thanks to store-in-store hearing aid center distribution, the problem of access to hearing aids diminishes with every year that goes by. In the beginning, Costco hearing aid centers were few and far between. Once the revenue and profit-driving force became evident, they became ubiquitous (Fig 2).

As fast as Costco warehouses have multiplied, Costco Hearing Aid Centers have multiplied faster. It's reminiscent of the old quip about the Starbucks location in the bathroom of a Starbucks (which hopefully is apocryphal).

And sales have kept up with infrastructure, too. In January of 2015, [Hearing Review](#) reported five years of 20% year-over-year growth of Costco hearing aid sales. With all that profitability, investment in infrastructure, and specialized employee training to fit a healthcare product, it makes

you wonder what Costco's thoughts are on over-the-counter instruments.

Tune in again for the next Costco installment, when we consider whether Costco's growth of market share signals a growth of the market itself or just a loss of share for other providers.

## Footnotes and References

<sup>1</sup>Pharmacy; optical dispensing centers; one-hour photo; food court and hot dog stands; hearing aid centers; copy centers; print shops; and gas stations comprise Costco's ancillary business division.

<sup>2</sup>Most Costco Wholesale Annual Reports can be found by [clicking here](#) and downloading the desired pdf. Early reports are harder to find but most exist and can be found with the right Internet search terms.

<sup>3</sup>Wyoming is interesting and we'll get back to it in a future post.

Boyle M. [Why Costco is so addictive](#). Fortune Magazine, Oct 25 2006.